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Corporate
Do's and Don'ts
for Start-Ups

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DO:

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#1 Do select the right entity type

As a new business, you basically have three types of entities to choose from: corporation, limited liability company, or partnership. If formed correctly, each provides vital limited liability protection. While a limited liability company or partnership is far more tax efficient than a corporation, if a venture capital investment is imminent, a corporation should be used, as most venture capital investors do not invest in partnerships or limited liability companies. You should consider other factors, including costs, procedures, management, and control.

#2 Do engage all consultants under "work-for-hire" agreements

Consultants are often more economically efficient than employees, especially for a start-up company. It is important to remember, however, that any arrangement with a consultant must be in writing and must clearly state that any work that the consultant is performing for the company, particularly technology development, is a "work-for-hire" and is assigned to the company, meaning that the company and not the consultant will have all ownership rights in the work, including any copyright, trade secret, or patent rights.

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#3 Do make a great first impression

Prepare an excellent, realistic “teaser” document to go along with your business plan, financial statements and company summary. Potential investors will take a closer look at a full set of materials if a start-up grabs their attention at the outset. Put thought and effort into a short, double-sided synopsis of the company and its highlights, and ensure that this teaser is the first thing any potential investor sees. Be creative and use color, graphics, graphs and other visual representations designed to catch the attention of the potential investor.

#4 Do incentivize your employees

Granting equity to employees aligns the goals of a company with the workers who are its lifeblood. Create a stock option plan and issue stock options to employees, allowing the success of the company to have a direct economic impact on each grantee. This energizes employees and brings a cohesive focus to the group. Make sure that the equity vests over time so that the longer an employee remains on board, the more he or she receives. You might also consider including a buyback right that allows the company to reacquire any such equity if the employee is terminated. A stand off employee option pool typically represents 10- 20% of company equity.

#5 Do consider licensing or joint ventures to monetize technology

A start-up company may find itself with a wonderful innovation, but may be unsure of how to use it to make money without relinquishing ownership rights. Two suitable options for monetizing technology are license arrangements and joint ventures, both of which allow a company to maintain control over the technology while putting such technology to use to generate revenue. Each such arrangement is carefully tailored to the particular technology and parties involved.

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DON'T

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#1 Don't give away too much equity

A start-up company is typically strapped for cash and entrepreneurs can be too quick to give equity to pay for important early costs and professional services. Be stingy with your equity—as the company grows, you will inevitably regret early grants when the value of your equity ends up being disproportionately larger than the value of the services or seed capital received. A good solution is to give seed investors promissory notes that convert into equity on the Series A funding. A good goal is not to have parted with more than one-third of the company by the completion of the Series A Round.

#2 Don't let your intellectual property walk out the door with former employees

Any ideas, designs, and other inventions that your employees develop during their employment should be the company's property. Every employee must sign a Proprietary Invention Assignment Agreement upon beginning employment. These agreements ensure that a company gets the full benefit of employee resources.

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DON'T

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#3 Don't be afraid to use connections

Networking is a vital way to spread the word about an emerging company, and it is just as important as a tool to locate investors. Founders should utilize their own personal business connections, but should not hesitate to ask corporate counsel or financial advisers for introductions and connections into their networks. These professionals will likely have a vast number of potential sources, and this broadens the company's access to funding opportunities.

#4 Don't get frustrated

The process of building a business is long and tedious and requires careful thought and flexibility— this is not an undertaking for the impatient or fainthearted. Make sure that you leave yourself sufficient personal financial leeway so as not to create financial strangulation for yourself or your family. Make sure that you research potential investors carefully—a targeted fund-raising approach is usually more successful than a bulk mailing to every fund in the phone book. Hire carefully—if you've never hired employees before, don't be hard on yourself if the first several do not meet your expectations. And most important, learn from your mistakes and don't give up.

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More questions?

Ask Us:

Lori Hoberman
lori@hobermanlawgroup.com
646.844.4860
group.com

Nick Scannavino
nick@hobermanlawgroup.com
646.856.9962

Angela D. Loc
angela@hobermanlawgroup.com
646.844.4863

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